Exhibit 13

EXCHANGE BANCSHARES, INC.

2003 ANNUAL REPORT

TO SHAREHOLDERS

EXCHANGE BANCSHARES, INC.

CONTENTS

EXCHANGE BANCSHARES, INC. – MISSION STATEMENT

Our mission is:

To maximize shareholder value and to provide a fair rate of return on shareholder investment compared to industry average;

To be responsive to customer needs, a partner in helping consumers and businesses in our market area achieve their financial goals;

To provide staff members with a positive environment in which to contribute corporate success and attain career objectives.

THE EXCHANGE BANK – MISSION STATEMENT

Our mission is to be the financial cornerstone of the communities we serve.

The Exchange Bank exists to provide superior banking services to our customers and provide its shareholders with a fair return on their investment.

To achieve our mission we will:

Remain an independent, locally-owned, caring institution, listening to our customers and the communities we serve;

Set high standards for employees by providing training, guidance and sense of pride, knowing that only through employee teamwork can our mission be accomplished;

Provide a superior level of internal service and support to one another;

Represent the Bank with the utmost pride, professionalism, and high standards of ethical behavior.

We believe a commitment to high employee performance and a focus on the quality of customer service are essential to our success and that building a great financial organization is an ongoing process.

March 29, 2004

Dear Shareholders:

Your Board of Directors considered 2003 as a year of continued adjustment and reorganization. During 2003, we faced many challenges relating to asset quality, earnings and operations. We feel these challenges presented management with opportunities to improve the performance of the Company and position us for future growth and profitability.

Earnings for 2003 were $301 thousand compared to a loss of $1.09 million in 2002. As of December 31, 2003, total assets were $102 million compared to $111 million at December 31, 2002. Total loans outstanding were $69 million at December 31, 2003 compared to $73 million at December 31, 2002. As of December 31, 2003 deposits were $92 million compared to $101 million at December 31, 2002.

Late in 2003, it was announced that our Bank Improvement Plan efforts to improve asset quality and operational efficiencies were one year into the process. With the Board of Directors involvement in corporate governance, it was decided to move forward with the next phase of the Plan, a new management team for The Exchange Bank. Your Board of Directors spent much time and effort in the search for qualified individuals to lead the Bank into its 100th year anniversary in 2006. As a result, Victor J. Proffitt was chosen to be the President and CEO of The Exchange Bank and Exchange Bancshares, Inc. The Board also chose F. Alan Blackburn as Executive Vice President of the Bank, in charge of banking centers and Senior Loan Officer. Both individuals are experienced bankers and reside in our market area.

Asset quality remains a high priority issue. The senior management team and entire staff are focusing much of their productive time and efforts to improve the asset quality of the Bank. These efforts include improved loan underwriting standards and a more focused approach in the collection of past due loans. Even though much progress has been made, the monitoring of asset quality will remain an ongoing process.

Your Board of Directors, senior management and staff are focused on the goal to increase our market share, improve earnings, maximize shareholder value and remain a locally-owned, independent, community bank. This will be accomplished by staffing our offices with well trained, community-minded banking professionals that you know and trust. To this end, many changes have taken place within our organization. We will continue to enhance and expand our existing products and services to provide the best possible customer service while maintaining a respectable profit margin for our shareholders.

As part of management's effort to develop new products and services, The Exchange Bank plans to provide it's customers with internet banking. You will be able to access your accounts through the Bank's website at www.theexchangebank.com. It is anticipated to be available in the second half of 2004.

With 2003 behind us, we can continue to move forward into our 98th year as a locally-owned, independent, community bank. This is due to the endless efforts of our entire staff, the dedication and commitment of our Board of Directors and the loyalty and support of our local communities, customers and shareholders. We sincerely thank all of you for the contribution that each has made during the year. Most important, our sincere thanks to all of our shareholders for their loyalty and support which has been afforded to us all of these years.

Sincerely,

/s/ Marion Layman | /s/ Victor J. Proffitt

Marion Layman
Chairman

Victor J. Proffitt
President & CEO

Exchange Bancshares, Inc.

Five-Year Summary of Selected Financial Data

Dollars in thousands, except per share data

Years Ended December 31,	2003	2002	2001	2000	1999
Statements of Income					
Interest income	$5,880	$7,035	$8,287	$8,261	$7,191
Interest expense	1,965	2,872	4,075	3,878	3,187
Net interest income	3,915	4,163	4,212	4,383	4,004
Provision for loan losses	250	2,019	15	75	0
Net interest income, after provision for loan losses	3,665	2,144	4,197	4,308	4,004
Non-interest income	592	768	680	552	641
Non-interest expenses	4,015	4,587	4,016	3,864	3,720
Income (loss) before income taxes	242	(1,675)	861	996	925
Income tax provision (credit)	(59)	(585)	269	320	300
Net income (loss)	$301	$(1,090)	$592	$676	$625
Per Common Share					
Net income (loss) – basic and diluted	$0.51	$(1.86)	$1.01	$1.16	$1.09
Cash dividends declared	0.25	0.25	0.50	0.49	0.47
Book value at year-end	15.68	15.72	17.85	17.01	16.05
Weighted average shares outstanding	586,644	586,644	585,553	583,870	575,726
Year End Balances					
Assets	$101,948	$110,688	$106,456	$103,155	$98,599
Securities	23,081	17,652	14,815	15,435	17,142
Loans	68,555	72,512	81,182	79,279	71,955
Deposits	92,249	100,845	95,231	90,108	83,541
Borrowed funds	86	100	115	2,632	5,152
Shareholders' equity	9,198	9,222	10,452	9,933	9,242
Ratios					
Return on average assets	0.28%	(1.01)%	0.55%	0.67%	0.66%
Return on average shareholders' equity	3.24%	(10.51)%	5.93%	7.18%	6.93%
Average shareholders' equity to average assets	8.69%	9.60%	9.26%	9.27%	9.54%
Dividend payout ratio	48.50%	-	49.49%	42.16%	43.04%

Description of Business

Exchange Bancshares, Inc. (the "Company") was incorporated in 1992 in the State of Ohio as a one-bank holding company for its wholly-owned subsidiary, The Exchange Bank (the "Bank"). The Company, through its subsidiary, operates in one industry segment, the commercial banking industry.

The Company is subject to regulation by the Board of Governors of the Federal Reserve System, which limits the activities in which the Company and the Bank may engage. The Bank is supervised by the State of Ohio, Division of Financial Institutions. The Bank is a member of the Federal Reserve System and is subject to its supervision. The Bank is also a member of the Federal Deposit Insurance Corporation (the "FDIC"). As such, the Bank is subject to periodic examination by the Division of Financial Institutions of the State of Ohio and the Federal Reserve Board. The Company and the Bank must file with the U.S. Securities and Exchange Commission, the Federal Reserve Board and Ohio Division of Financial Institutions the prescribed periodic reports containing full and accurate statements of its affairs.

The Bank, an Ohio chartered bank organized in 1906, provides financial services through its five branches located in Luckey, Ohio, and nearby communities. These communities are the source of substantially all deposit and loan activities. The majority of the Bank's income is derived from commercial and retail lending activities and investments in securities. Its primary deposit products are checking, savings, and term certificate accounts, and its primary lending products are residential mortgage, commercial, and installment loans. Substantially all loans are secured by specific items of collateral including business assets, consumer assets and real estate. Commercial loans are expected to be repaid from cash flow from operations of business. Real estate loans are secured by both residential and commercial real estate.

Market for Common Equity and Related Stockholder Matters

At December 31, 2003, the Company had approximately 796 shareholders of record. Sweney Cartwright & Co. and McDonald & Company, broker-dealers, make a limited over-the-counter market in shares of the Company's Common Stock. There are no plans to list the shares of the Common Stock on any stock exchange. Through 2003, Sweney Cartwright & Co. and McDonald & Company purchased and sold shares of stock of the Company at prices ranging from $17.25 to $19.75 per share. The offer to purchase shares, in some instances, was conditional upon their ability to sell the shares at a predetermined price.

	March 31, 2003	June 30, 2003	September 30, 2003	December 31, 2003
High	$19.75	$18.75	$18.25	$19.75
Low	18.10	17.25	17.35	17.55
Dividend	0.00	0.20	0.00	0.05

	March 31, 2002	June 30, 2002	September 30, 2002	December 31, 2002
High	$19.00	$19.60	$20.00	$20.00
Low	18.00	18.15	19.00	19.00
Dividend	0.00	0.20	0.00	0.05

Availability of Financial Information

The Company files unaudited quarterly financial reports under Form 10-QSB and annual financial reports under Form 10-KSB with the Securities and Exchange Commission (the "SEC"). Copies of these reports are available by writing to:

Joseph R. Hirzel, Secretary
Exchange Bancshares, Inc.
237 Main Street, P.O. Box 177
Luckey, Ohio 43443-0177

Financial reports and other materials filed by the Company with the SEC may also be read and copied at the SEC's Public Reference Room at 450 Fifth Street, N.W., Washington, D.C. 20549. Information on the operation of the Public Reference Room may be obtained from the SEC by calling 1-800-SEC-0330. The SEC also maintains an internet site (www.sec.gov) that contains reports, proxy and information statements, and other information regarding registrants that file reports electronically, as the Company does.

Forward-Looking Statements

When used in this Form 10-KSB, the words or phrases "will likely result," "are expected to," "will continue," "is anticipated," "estimated," "projected," or similar expressions are intended to identify forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. Such statements are subject to certain risks and uncertainties, including changes in economic conditions in the Bank's market area, changes in policies by regulatory agencies, fluctuations in interest rates, demand for loans in the Bank's market area and competition, that could cause actual results to differ materially from historical earnings and those presently anticipated or projected. Factors listed above could affect the Company's financial performance and could cause the Company's actual results for future periods to differ materially from any statements expressed with respect to future periods.

In additional to the historical information contained herein, the following discussion contains forward-looking statements that involve risks and uncertainties. Economic circumstances, the operations of the Bank, and the Company's actual results could differ significantly from those discussed in the forward-looking statements. Some of the factors that could cause or contribute to such differences are discussed herein, but also include changes in the economy and changes in interest rates in the nation and the Company's primary market area.

Management's Discussion and Analysis of Financial Condition and Results of Operations

The following discussion and analysis represents a review of the Company's consolidated financial condition and results of operations. This review should be read in conjunction with the consolidated financial statements presented elsewhere in this report.

Without limiting the generality of the foregoing, some of the forward-looking statements included herein are the statements under the following headings and regarding the following matters:

1. Financial Condition. Management's statements regarding the amount and adequacy of the allowance for loan losses at December 31, 2003.

2. Comparison of Results of Operations for the Fiscal Years Ended December 31, 2003 and 2002 – "Provision for Loan Losses". Management's statements regarding the adequacy of the allowance for loan losses at December 31, 2003.

3. Liquidity and Capital Resources. Management's belief that liquidity and capital reserves are sufficient to meet its outstanding short-term and long-term needs.

The Company does not undertake, and specifically disclaims any obligations, to publicly revise any forward-looking statements to reflect events or circumstances after the date of such statements or to reflect the occurrence of anticipated or unanticipated events.

Financial Condition

As of December 31, 2003, the Company had total assets of $101,948,000, $68,555,000 in loans, $92,249,000 in deposits, and $9,198,000 in shareholders' equity.

Loan Portfolio

Loans, as a component of earning assets, represent a significant portion of earning assets at December 31, 2003. As presented in the "Consolidated Average Balance Sheets and Related Yields and Rates" table, included herein, average loans decreased 13.1% in 2003 to represent 69.5% of average interest-earning assets compared to 79.0% in 2002 and 77.8% in 2001. Total loans decreased from $72,512,000 at December 31, 2002 to $68,555,000 at December 31, 2003. This represents a decrease of $3,957,000, or 5.5%, from the previous year. The decrease was primarily due to decreases in nonresidential real estate loans of $5,327,000 or 19.9%, consumer loans of $1,644,000 or 14.5%, construction loans of $967,000 and agricultural loans of $470,000, partially offset by an increase in residential real estate loans of $5,071,000 or 18.3%. The majority of the decrease was a result of the Bank initiating stricter underwriting standards, as well as payoffs of certain large commercial real estate loans, and an increase in charged-off loans due to bankruptcies and a more conservative approach in evaluating credit quality.

The following table provides a five-year summary of the loan portfolio (dollars in thousands).

December 31,	2003	2002	2001	2000	1999
Loans secured by real estate:					
Construction	$1,291	$2,258	$1,694	$833	$133
Residential properties	32,758	27,687	32,994	37,854	37,333
Nonresidential properties, including farm land	21,377	26,704	28,141	24,157	20,467
Agricultural production	633	1,103	852	816	806
Commercial and industrial	1,838	2,582	3,596	2,544	3,053
Consumer	9,714	11,358	13,637	12,935	10,013
Municipal	944	820	268	140	150
Total	$68,555	$72,512	$81,182	$79,279	$71,955
Loans secured by real estate:					
Construction	1.9%	3.1%	2.1%	1.1%	0.2%
Residential properties	47.8%	38.2%	40.6%	47.7%	51.9%
Nonresidential properties, including farm land	31.2%	36.8%	34.7%	30.5%	28.5%
Agricultural production	0.9%	1.5%	1.1%	1.0%	1.1%
Commercial and industrial	2.7%	3.6%	4.4%	3.2%	4.2%
Consumer	14.1%	15.7%	16.8%	16.3%	13.9%
Municipal	1.4%	1.1%	0.3%	0.2%	0.2%
Total	100.0%	100.0%	100.0%	100.0%	100.0%

The following table shows the amount of commercial, agricultural and municipal loans, real estate nonresidential loans and real estate construction loans at December 31, 2003 (dollars in thousands).

December 31, 2003	Within 1 Year	1 - 5 Years	After 5 Years	Total
Commercial, agricultural and municipal	$1,788	$1,167	$460	$3,415
Real estate nonresidential	1,225	2,109	18,043	21,377
Real estate construction	870	421	0	1,291
Total	$3,883	$3,697	$18,503	$26,083
Fixed	$2,721	$1,539	$512	$4,772
Variable	1,162	2,158	17,991	21,311
Total	$3,883	$3,697	$18,503	$26,083

Off-Balance Sheet Arrangements

In addition to the loans reported in the Loan Information table, there are certain off-balance sheet products such as loan commitments and letters of credit, which are offered under the same credit standards as the loan portfolio. Generally accepted accounting principles require that these financial instruments be disclosed but not reflected in the accompanying consolidated financial statements. Management closely monitors the financial condition of potential creditors throughout the terms of the instrument to assure that they maintain certain credit standards. Refer to Note 8 of the Notes to Consolidated Financial Statements for additional information on off-balance sheet financial instruments.

Non-Performing Assets

Non-performing assets are defined as loans accounted for on a non-accrual basis, accruing loans that are contractually past due 90 days or more as to principal or interest payments, renegotiated troubled debt and other real estate owned obtained through loan foreclosure.

A loan is placed on non-accrual when payment terms have been seriously violated (principal and/or interest payments are past due 90 days or more, deterioration of the borrower's ability to repay, or significant decrease in value of the underlying loan collateral) and stays on non-accrual until the loan is brought current as to principal and interest. The classification of a loan or other asset as non-accruing does not indicate that loan principal and interest will not be collectible. The Bank adheres to the policy of the Federal Reserve that banks may not accrue interest on any loan when the principal or interest is due and has remained unpaid for 90 days or more unless the loan is both well secured and in the process of collection.

A loan is considered restructured or renegotiated when either the rate is reduced below current market rates for that type of risk, principal or interest is forgiven, or the term is extended beyond that which the Bank would accept for loans with comparable risk.

Loans accounted for on a non-accrual basis at December 31, 2003, were $627,000 as compared to $1,351,000 at December 31, 2002. Non-performing assets at December 31, 2003, totaled $2,269,000 as compared to $3,265,000 at December 31, 2002, a decrease of $996,000 or 30.5%. The decrease is primarily due to the non-accrual loans being charged-off against the allowance for loan losses or repaid with funds from other sources. Management is continuing to monitor these assets and strengthen the Bank's position whenever possible.

Other real estate owned consists of real estate properties, generally acquired through foreclosure action or the borrower voluntarily deeding the property to the Bank. Properties obtained from foreclosing on loans secured by real estate are recorded at the lower of cost or market value. Other real estate owned decreased from $1,150,000 at December 31, 2002 to $237,000 at December 31, 2003. At December 31, 2003, the Bank held two properties, one residential real estate parcel and one commercial parcel.

The following table provides a five-year summary of non-performing assets (dollars in thousands).

December 31,	2003	2002	2001	2000	1999
Non-accrual loans	$627	$1,351	$921	$357	$10
Restructured loans	372	11	14	0	0
Loans past due 90 days or more and still accruing	1,033	753	787	195	74
Total non-performing loans	2,032	2,115	1,722	552	84
Other real estate owned	237	1,150	92	0	0
Total non-performing assets	$2,269	$3,265	$1,814	$552	$84
Ratios					
Non-performing loans to total loans	2.96%	2.92%	2.12%	0.70%	0.12%
Non-performing assets to total loans plus other real estate owned	3.30%	4.43%	2.23%	0.70%	0.12%

Provision and Allowance for Loan Losses

The allowance for loan losses was established and is maintained by periodic charges to the provision for loan losses, an operating expense, in order to provide for probable losses inherent in the Bank's loan portfolio. Loan losses and recoveries are charged or credited, respectively, to the allowance for loan losses as they occur.

To identify and manage the risks of lending, reviews of the loan portfolio are made on a continuous basis to identify problem loans. Management has internal and external loan review procedures that provide for analysis of problem loans. Other factors to consider in the analysis of the loan portfolio include general economic conditions, credit quality trends and regulatory examination findings. Internally identified "Watch Loans" are graded for asset quality by either the senior loan officer and/or the internal/external review staff. The results of the grading process in conjunction with independent collateral evaluations are used by management and the Board of Directors in determining the adequacy of the allowance for loan losses account on a quarterly basis. The entire allowance for loan losses is available to absorb any particular loan loss. Management believes that the allowance for loan losses is adequate to cover potentially uncollectible loans at December 31, 2003.

The provision for loan losses for 2003 was $250,000 compared with $2,019,000 for 2002 and $15,000 for 2001. The changes in the provision for loan losses was primarily due to changes in net charge-offs, the level of non-performing loans and changes in risk factors within the loan portfolio. At December 31, 2003, the allowance for loan losses was $1,395,000 or 2.03% of total loans, and 68.7% of total non-performing loans, compared to the allowance for loan losses at December 31, 2002 of $1,417,000 or 1.95% of total loans and 67.0% of total non-performing loans.

The provision for loan losses was $2,019,000 for 2002, an increase of $2,004,000 compared to $15,000 for the same period in 2001. The increase in provision for loan losses was primarily attributable to higher net charge-offs and the increase in non-performing loans. The higher net charge-offs were primarily due to a deterioration of credit quality in the loan portfolio, a related increase in bankruptcies declared by loan customers and one large commercial loan.

The following table provides a five-year summary of allowance for loan losses activity (dollars in thousands).

	2003	2002	2001	2000	1999
Balance at beginning of year	$1,417	$844	$756	$1,008	$1,542
Charge-offs:					
Real estate	141	396	0	0	0
Commercial and agricultural	20	318	92	239	460
Consumer	213	647	116	49	54
Credit card	166	197	52	118	80
Total charge-offs	540	1,558	260	406	594
Recoveries:					
Real estate	74	10	1	2	17
Commercial and agricultural	31	27	238	65	1
Consumer	145	70	79	11	21
Credit card	18	5	15	1	21
Total recoveries	268	112	333	79	60
Net charge-offs	272	1,446	(73)	327	534
Provision for loan losses	250	2,019	15	75	0
Balance at end of year	$1,395	$1,417	$844	$756	$1,008
Allocation of Allowance for Loan Losses:					
Real estate	$337	$192	$52	$6	$173
Commercial and agricultural	515	555	408	172	471
Consumer and credit card	349	200	135	104	145
Unallocated	194	470	249	474	219
Total	$1,395	$1,417	$844	$756	$1,008
Ratios					
Net charge-offs to average loans	0.39%	1.81%	(0.09)%	0.42%	0.79%
Allowance for loan losses to total loans	2.03%	1.95%	1.04%	0.95%	1.40%
Allowance for loan losses to non-performing loans	68.65%	67.00%	49.01%	136.96%	1200.00%

Investments

Securities are designated at the time of purchase as either held-to-maturity or available-for-sale. Presently, all securities other than restricted stock are designated as available-for-sale and carried at fair value, with unrealized gains and losses, net of applicable taxes, on such securities recognized as other comprehensive income (loss). Restricted stock is carried at cost and evaluated for impairment. At December 31, 2003, securities, including restricted stock, totalled $23,081,000, an increase of $5,429,000 or 30.8% from $17,652,000 at December 31, 2002. The increase in securities is primarily due to the reallocation of funds from the decrease in the loan portfolio.

The Bank utilizes an outside investment firm to analyze, evaluate and offer investment recommendations to management based on such criteria as security ratings, yields and terms. All securities must pass a stress test at the time of purchase estimating how the security would perform in various interest rate environments. Funds allocated to the securities portfolio are constantly monitored by management to ensure that a proper ratio of liquidity and earnings is maintained.

At December 31, 2003, federal funds sold were $4,341,000 a decrease of $8,174,000 or 65.3% from $12,515,000 at December 31, 2002. The decrease in federal funds sold is due to the outflow of deposits. Management maintains federal funds sold balances consistently at levels that will cover the short-term liquidity needs of the Bank.

The following table shows the contractual maturities and weighted average yields of the Company's available-for-sale securities as of December 31, 2003 (dollars in thousands).

	Amortized Cost								
	Within 1 Year		1 - 5 Years		5 - 10 Years		Total		Total
December 31, 2003	Amount	Yield	Amount	Yield	Amount	Yield	Amount	Yield	Fair Value
U.S. Treasury	$509	3.68%	$1,042	3.81%	-	-	$1,551	3.77%	$1,601
Federal Agency	2,991	4.29%	15,425	2.68%	-	-	18,416	2.95%	18,510
Mortgage-Backed	-	-	777	2.04%	-	-	777	2.04%	771
Corporate Debt	1,510	5.06%	-	-	-	-	1,510	5.06%	1,534
Total	$5,010	4.46%	$17,244	2.72%	-	-	$22,254	3.12%	$22,416

Deposits

At December 31, 2003, deposits were $92,249,000, a decrease of $8,596,000 or 8.5% from $100,845,000 at December 31, 2002. The decrease was primarily due to a decrease of $7,893,000 in certificates of deposit. The decrease in certificates of deposit was due to higher rate interest-bearing certificates maturing and transferring to other financial institutions.

The following table provides a five-year summary of deposits by product (dollars in thousands):

December 31,	2003	2002	2001	2000	1999
Noninterest-bearing deposits	$10,438	$11,535	$10,943	$9,446	$9,587
NOW and money market accounts	16,628	16,168	16,615	14,395	14,357
Savings accounts	18,543	17,862	16,757	15,128	15,713
Individual retirement accounts	6,442	7,189	6,339	6,062	5,791
Certificates of deposits	40,198	48,091	44,577	45,077	38,093
Total	$92,249	$100,845	$95,231	$90,108	$83,541

The following table is a schedule of certificates of deposit of $100,000 or more as of December 31, 2003 (dollars in thousands):

December 31, 2003	Within 3 Months	3 - 6 Months	6 - 12 Months	Over 12 Months	Total
Certificates of Deposit of $100,000 or More	$2,105	$1,472	$3,299	$4,824	$11,700

Borrowed Funds

The Bank is a member of the Federal Home Loan Bank and may obtain both overnight and term advances. See Note 5 of the Notes to Consolidated Financial Statements for more information.

Capital Resources

At December 31, 2003, shareholders' equity was $9,198,000 or 9.02% of total assets compared to $9,222,000 or 8.33% of total assets at December 31, 2002. The decrease was due to a reduction of $179,000 in unrealized gains on available-for-sale securities and the payment of $146,000 in cash dividends, partially offset by net income of $301,000.

The Federal Reserve Board has established risk-based capital requirements for bank holding companies and banks. The primary purpose of these requirements is to assess the risk in a financial institution's balance sheet and off-balance sheet financial instruments in relation to adjusted capital. To be considered well-capitalized under prompt corrective action, the Bank is required to maintain a minimum total qualifying capital of at least 10% and Tier I (Core) capital of at least 6%. Tier I capital includes common equity, non-cumulative perpetual preferred stock, and minority interest less goodwill and other disallowed intangibles. Tier II (supplementary) capital includes subordinated debt, intermediate-term preferred stock, the allowance for loan losses and preferred stock not qualifying for Tier I capital. At December 31, 2003, the Bank's risk-based capital ratio for Tier I and Tier II capital was 13.4% and 14.7%, respectively. A detailed summary of the capital amounts and selected rates is provided in Note 11 of the Notes to Consolidated Financial Statements.

Liquidity and Market Risk

Exchange Bancshares, Inc. is a holding company and does not conduct operations. Its primary source of liquidity is dividends from the Bank. Generally, subject to certain minimum capital requirements, the Bank may declare a dividend without regulatory approval unless the total dividends in a calendar year exceed the total of the Bank's net profits for the year combined with its retained profits of the two preceding years.

The Bank manages liquidity and market risk through its Asset / Liability Committee (ALCO). The ALCO Committee assesses interest rate risk by monitoring current economic conditions and ensuring that the Bank has funds available to satisfy the normal loan and deposit needs of its customers while taking advantage of investment opportunities as they arise in order to maintain consistent growth and earnings. The Bank maintains a stable core deposit base and adequate liquidity through the use of federal funds sold and investment securities.

The difference between the Bank's interest rate sensitive assets that reprice within a specific time period and interest rate sensitive liabilities that reprice within a specific time period is commonly referred to as the Bank's "interest rate sensitivity gap." In periods of declining interest rates, a liability sensitive position is more favorable as interest rate sensitive liabilities may be adjusted to declining market rates prior to maturing interest rate sensitive assets. In periods of rising interest rates, an asset sensitive position is more favorable as interest rate sensitive assets may be adjusted to rising market rates prior to maturing interest rate sensitive liabilities.

The following table shows the Company's interest rate sensitivity position as of December 31, 2003 (dollars in thousands).

December 31, 2003	Within 3 Months	Over 3 Months to 1 Year	Over 1 Year to 3 Years	Over 3 Years to 5 Years	After 5 Years	Total
Interest-bearing deposits in banks	$ 9	$ -	$ -	$ -	$ -	$ 9
Federal funds sold	4,341	-	-	-	-	4,341
Securities	503	5,149	14,042	2,722	665	23,081
Loans	13,575	12,563	17,314	9,026	16,077	68,555
Other assets	-	-	-	-	5,962	5,962
Total assets	$18,428	$17,712	$31,356	$11,748	$22,704	$101,948
Interest-bearing deposits	$14,631	$24,691	$25,388	$8,913	$8,188	$81,811
Borrowed funds	1	11	22	19	33	86
Noninterest-bearing deposits	-	-	-	-	10,438	10,438
Other liabilities and equity	-	-	-	-	9,613	9,613
Total liabilities and equity	$14,632	$24,702	$25,410	$8,932	$28,272	$101,948
Gap	$3,796	$(6,990)	$5,946	$2,816	$(5,568)	
Cumulative gap	3,796	(3,194)	2,752	5,568	0	
Cumulative gap to total assets	3.72%	(3.13)%	2.70%	5.46%		

The above table includes mortgage-backed securities with maturities projected based on anticipated cash flows rather than final maturity.

Summary

For 2003, the Company's net income was $301,000 or $0.51 per share compared to a net loss of $(1,090,000) or $(1.86) per share for 2002 and net income of $592,000 or $1.01 per share for 2001. The net loss for 2002 was primarily due to the $2,019,000 provision for loan losses. The decrease in net income for 2003 as compared to 2001 was primarily due to a decrease in net interest income and an increase in the provision for loan losses. The decrease in net interest income was due to lower volumes of higher yielding loans. Return on average assets (ROA) was 0.28%, (1.01)% and 0.55% in 2003, 2002 and 2001, respectively. Return on average equity (ROE) was 3.24%, (10.51)% and 5.93% in 2003, 2002 and 2001, respectively.

Exchange Bancshares, Inc.

Net Interest Income

Net interest income, the interest income earned on interest-earning assets less interest expense incurred on interest-bearing liabilities is the Company's primary source of earnings. The following table entitled "Consolidated Average Balance Sheets and Related Yields and Rates" presents the Company's net interest income for the years ended December 31, 2003, 2002 and 2001 and summarizes the Company's (i) average assets, liabilities and shareholders' equity (ii) interest income earned and interest expense incurred, (iii) average yield earned on interest-earning assets and average rate incurred on interest-bearing liabilities and (iv) net interest spread and net interest margin. Average yields on interest-earnings assets have been prepared on a tax-equivalent basis (using a 34% tax rate) and non-accrual loans have been included in the average loan balances.

Consolidated Average Balance Sheets and Related Yields and Rates

	2003			2002			2001		
	Average Balance	Interest Income / Expense	Average Yields / Rates	Average Balance	Interest Income / Expense	Average Yields / Rates	Average Balance	Interest Income / Expense	Average Yields / Rates
				(dollars in thousands)					
Assets:									
Interest-earning deposits in banks	$19	$ -	- %	$37	$ -	- %	$35	$2	4.45%
Federal funds sold	9,458	105	1.11%	5,768	87	1.51%	7,622	266	3.49%
Securities	20,860	746	3.58%	15,433	808	5.24%	14,870	886	5.96%
Loans (1) (2)	69,281	5,044	7.28%	79,717	6,140	7.70%	78,724	7,137	9.07%
Total interest-earning assets	99,618	5,895	5.92%	100,955	7,035	6.97%	101,251	8,291	8.19%
Cash and due from banks	2,629			3,101			2,564		
Allowance for loan losses	(1,291)			(886)			(808)		
Other assets	5,808			4,838			4,894		
Total assets	$106,764			$108,008			$107,901		
Liabilities and Shareholders' Equity:									
NOW accounts	$15,532	221	1.42%	$16,437	508	3.09%	$14,839	540	3.64%
Money market accounts	1,491	14	0.94%	1,068	16	1.50%	1,151	27	2.35%
Savings accounts	18,206	84	0.46%	17,215	201	1.17%	16,086	326	2.03%
Time deposits	50,619	1,640	3.24%	51,345	2,131	4.15%	54,673	3,148	5.76%
Total interest-bearing deposits	85,848	1,959	2.28%	86,065	2,856	3.32%	86,749	4,041	4.66%
Borrowed funds	93	6	6.45%	572	16	2.80%	523	34	6.50%
Total interest-bearing liabilities	85,941	1,965	2.29%	86,637	2,872	3.32%	87,272	4,075	4.67%
Noninterest-bearing deposits	11,019			10,498			10,097		
Other liabilities	526			502			541		
Shareholders' equity	9,278			10,371			9,991		
Total liabilities and shareholders' equity	$106,764			$108,008			$107,901		
Net interest income on a tax-equivalent basis		$3,930			$4,163			$4,216	
Net interest spread			3.63%			3.65%			3.52%
Net yield on interest-earning assets			3.95%			4.12%			4.16%

NOTES:

(1) Interest income includes loan fees.

(2) Non-accrual loans are included in loans and do not have a material impact on the analysis.

Changes in net interest income may also be analyzed by comparing volume and rate components of interest income and interest expense. The table entitled "Rate and Volume Analysis" presents an analysis of the changes in interest income and interest expense in terms of changes in volume and interest rates for the years ended December 31, 2003, 2002 and 2001.

Rate and Volume Analysis

Changes in Tax Equivalent Interest Income	2003 vs. 2002 Volume	2003 vs. 2002 Yield / Rate	2003 vs. 2002 Total	2002 vs. 2001 Volume	2002 vs. 2001 Yield / Rate	2002 vs. 2001 Total
			(dollars in thousands)			
Assets:						
Interest-earning deposits in banks	$0	$0	$0	$0	$(2)	$(2)
Federal funds sold	31	(13)	18	(65)	(114)	(179)
Securities	237	(299)	(62)	34	(112)	(78)
Loans	(762)	(334)	(1,096)	90	(1,087)	(997)
Total	(494)	(646)	(1,140)	59	(1,315)	(1,256)
Liabilities:						
NOW accounts	(28)	(259)	(287)	58	(90)	(32)
Money market accounts	6	(8)	(2)	(2)	(9)	(11)
Savings accounts	12	(129)	(117)	23	(148)	(125)
Time deposits	(30)	(461)	(491)	(192)	(825)	(1,017)
Borrowed funds	(20)	10	(10)	3	(21)	(18)
Total	(60)	(847)	(907)	(110)	(1,093)	(1,203)
Change in net interest income	$(434)	$201	$(233)	$169	$(222)	$(53)

The average yield on interest-earning assets has decreased to 5.92% in 2003 from 6.97% and 8.19% in 2002 and 2001, respectively. The decrease was primarily due to higher yielding interest-earning assets repricing at lower interest rates due to the current rate environment and increased competition from other financial institutions. The average rate on interest-bearing liabilities has also declined due to the repricing of deposits at lower current market interest rates. The average rate on interest-bearing liabilities has decreased to 2.29% in 2003 from 3.32% and 4.67% in 2002 and 2001, respectively. The net effect of the changes in yields and rates resulted in a decrease in the net yield on interest-earning assets for 2003. The changes in both asset and liability volumes in 2003 coupled with repricing of both interest-earning assets and interest-bearing liabilities resulted in a decrease of $233,000 in net interest income.

Non-Interest Income

The following table summarizes the components of the Company's non-interest income for the years ended December 31, 2003, 2002 and 2001 (dollars in thousands).

Year ended December 31,	2003	2002	2001	2003 vs. 2002	2002 vs. 2001
Service charges on deposits	$403	$389	$328	3.6%	18.6%
Secondary market loan fees	98	163	188	(39.9)%	(13.3)%
Fees on annuities and mutual funds	25	131	99	(80.9)%	32.3%
Net gains on sales of securities	29	19	-	52.6%	-
Other income	37	66	65	(43.9)%	1.5%
Total non-interest income	$592	$768	$680	(22.9)%	12.9%

Non-interest income decreased $176,000 or 22.9% to $592,000 in 2003 compared to $768,000 in 2002 and $680,000 in 2001. The decrease was primarily due to decreases of $106,000 or 80.9% in fees on sales of annuities and mutual funds, $65,000 or 39.9% in secondary market loan fees and $29,000 or 43.9% in other non-interest income, partially offset by slight increases in service charges on deposit accounts and net gains on the sales of securities. The decrease in fees on annuities and mutual funds was due to the termination of an agreement, between the Company and an outside service provider, for the sales of annuities and mutual funds through the Company. The decrease in secondary market loan fees was due to lower volume and the decrease in other non-interest income was due to a loss on the sale of a commercial real estate property.

Non-Interest Expenses

The following table summarizes the components of the Company's non-interest expenses for the years ended December 31, 2003, 2002 and 2001 (dollars in thousands).

Year ended December 31,	2003	2002	2001	2003 vs. 2002	2002 vs. 2001
Salaries, wages and employee benefits	$1,955	$2,230	$2,008	(12.3)%	11.1%
Net occupancy and equipment	574	584	620	(1.7)%	(5.8)%
Bank, ATM and credit card charges	181	192	183	(5.7)%	4.9%
Data processing	170	165	154	3.0%	7.1%
Directors fees	130	110	70	18.2%	57.1%
Examination and accounting fees	175	203	150	(13.8)%	35.3%
State and other taxes	107	123	124	(13.0)%	(0.8)%
Postage and courier	110	122	119	(9.8)%	2.5%
Supplies and printing	79	136	119	(41.9)%	14.3%
Advertising	55	130	110	(57.7)%	18.2%
Legal	109	199	97	(45.2)%	105.2%
Telephone	94	79	75	19.0%	5.3%
Other expenses	276	314	187	(12.1)%	67.9%
Total Non-interest Expense	$4,015	$4,587	$4,016	(12.5)%	14.2%

Non-interest expenses decreased $572,000 or 12.5% to $4,015,000 in 2003 compared to $4,587,000 in 2002 and $4,016,000 in 2001. The decrease was primarily due to decreases of $275,000 or 12.3% in salaries, wages and employee benefits, $90,000 or 45.2% in legal fees, $75,000 or 57.7% in advertising and $57,000 or 41.9% in supplies and printing. The decrease in salaries, wages and employee benefits was primarily due to management and staffing changes within the Bank. The decreases in legal fees, advertising and supplies and printing were primarily due to efforts of management to control costs by diligently reviewing all areas of operations and contracts with vendors for reductions in expense.

Income Taxes

The Company's provision (credit) for income taxes was $(59,000) in 2003, $(585,000) in 2002, and $269,000 in 2001, representing an effective tax rate of (24.3)%, 34.9%, and 31.2%, respectively. The effective tax rate in 2003 was impacted by a $138,000 decrease in the valuation allowance for deferred tax assets, as disclosed in Note 7 to the Company's Consolidated Financial Statements.

Impact of Inflation

The financial statements and related data presented herein have been prepared in accordance with generally accepted accounting principles, which require the measurement of financial position and results of operations primarily in terms of historical dollars without considering changes in the relative purchasing power of money over time because of inflation. Virtually all assets and liabilities of the Company are monetary in nature. As a result, interest rates have a more significant impact on performance than the effects of general levels of inflation.

Recently Issued Accounting Pronouncements

The Company does not believe the adoption of any recently issued pronouncements by the Financial Accounting Standards Board will have a significant impact on its consolidated financial statements.

Significant Accounting Policies

The Company's consolidated financial statements are prepared in accordance with accounting principles generally accepted in the United States of America and follow general practices within the commercial banking industry. Application of these principles requires management to make estimates, assumptions, and judgments that affect the amounts reported in the financial statements. These estimates, assumptions, and judgments are based upon the information available as of the date of the financial statements.

The most significant accounting policies followed by the Company are presented in the Summary of Significant Accounting Policies. These policies, along with the other disclosures presented in the Notes to Consolidated Financial Statements and in Management's Discussion and Analysis, provide information about how significant assets and liabilities are valued in the financial statements and how those values are determined. Management has identified the determination of the allowance for loan losses as the accounting area that requires the most subjective and complex estimates, assumptions, and judgments and, as such, could be the most subject to revision as new information becomes available.

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Independent Auditor's Report

Shareholders and Board of Directors
Exchange Bancshares, Inc.
Luckey, Ohio

We have audited the accompanying consolidated balance sheet of Exchange Bancshares, Inc. and its subsidiary as of December 31, 2003, and the related consolidated statements of operations, shareholders' equity, and cash flows for the year then ended. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audit. The consolidated balance sheet of Exchange Bancshares, Inc. as of December 31, 2002, and the related consolidated statements of operations, shareholders' equity and cash flows for the years ended December 31, 2002 and 2001, were audited by other auditors whose report dated January 23, 2003, expressed an unqualified opinion on those financial statements.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the 2003 consolidated financial statements referred to above present fairly, in all material respects, the financial position of Exchange Bancshares, Inc. and its subsidiary as of December 31, 2003, and the results of their operations and their cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

/s/ CLIFTON GUNDERSON LLP

Toledo, Ohio
January 23, 2004

EXCHANGE BANCSHARES, INC.
CONSOLIDATED BALANCE SHEETS
December 31, 2003 and 2002

ASSETS	2003	2002
	(Dollars in thousands, except par value)	
CASH AND CASH EQUIVALENTS		
Cash and due from banks	$ 2,352	$ 3,221
Interest-bearing demand deposits in banks	9	29
Federal funds sold	4,341	12,515
Total cash and cash equivalents	6,702	15,765
SECURITIES		
Available-for-sale, at fair value	22,416	17,006
Restricted stock, at cost	665	646
Total securities	23,081	17,652
LOANS	68,555	72,512
Less allowance for loan losses	1,395	1,417
Net loans	67,160	71,095
PREMISES AND EQUIPMENT, NET	3,495	3,395
OTHER REAL ESTATE OWNED	237	1,150
ACCRUED INTEREST RECEIVABLE AND OTHER ASSETS	1,273	1,631
TOTAL ASSETS	$ 101,948	$ 110,688

LIABILITIES AND SHAREHOLDERS' EQUITY

	2003	2002
LIABILITIES		
Deposits:		
Non-interest bearing	$ 10,438	$ 11,535
Interest-bearing	81,811	89,310
Total deposits	92,249	100,845
Federal Home Loan Bank borrowing	86	100
Accrued interest payable and other liabilities	415	521
Total liabilities	92,750	101,466
SHAREHOLDERS' EQUITY		
Preferred shares, $25.00 par value. Authorized 750 shares; no shares issued	-	-
Common stock, $5.00 par value. Authorized 750,000 shares; issued and outstanding 586,644 shares	2,933	2,933
Additional paid-in capital	5,071	5,071
Retained earnings	1,087	932
Accumulated other comprehensive income	107	286
Total shareholders' equity	9,198	9,222
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	$ 101,948	$ 110,688

These consolidated financial statements should be read only in connection with the accompanying summary of significant accounting policies and notes to consolidated financial statements.

EXCHANGE BANCSHARES, INC.
CONSOLIDATED STATEMENTS OF OPERATIONS
Years Ended December 31, 2003, 2002 and 2001

	2003	2002	2001
	(Dollars in thousands, except per share data)		
INTEREST INCOME			
Loans, including fees	$ 5,029	$ 6,140	$ 7,134
Investment securities	746	808	885
Federal funds sold and other	105	87	268
Total interest income	5,880	7,035	8,287
INTEREST EXPENSE			
Deposits	1,959	2,856	4,041
Federal Home Loan Bank borrowings	6	16	34
Total interest expense	1,965	2,872	4,075
Net interest income	3,915	4,163	4,212
PROVISION FOR LOAN LOSSES	250	2,019	15
Net interest income, after provision for loan losses	3,665	2,144	4,197
NON-INTEREST INCOME			
Service charges on deposit accounts	403	389	328
Secondary market loan fees	98	163	188
Fees on sales of annuities and mutual funds	25	131	99
Securities gains	29	19	-
Other	37	66	65
Total non-interest income	592	768	680
NON-INTEREST EXPENSES			
Salaries, wages and employee benefits	1,955	2,230	2,008
Occupancy of premises	574	584	620
Bank, ATM and credit card charges	181	192	183
Data processing	170	165	154
Directors fees	130	110	70
Examination and accounting fees	175	203	150
State and other taxes	107	123	124
Postage and courier	110	122	119
Supplies and printing	79	136	119
Advertising	55	130	110
Legal	109	199	97
Telephone	94	79	75
Other	276	314	187
Total non-interest expenses	4,015	4,587	4,016
Income (loss) before federal income taxes	242	(1,675)	861
FEDERAL INCOME PROVISION (CREDIT)	(59)	(585)	269
NET INCOME (LOSS)	$ 301	$ (1,090)	$ 592
NET INCOME (LOSS) PER SHARE, based on 586,644 shares in 2003 and 2002, and 585,553 shares in 2001	$ 0.51	$ (1.86)	$ 1.01

These consolidated financial statements should be read only in connection with the accompanying summary of significant accounting policies and notes to consolidated financial statements.

EXCHANGE BANCSHARES, INC.
CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY
Years Ended December 31, 2003, 2002 and 2001

	Common Stock	Additional paid-in capital	Retained earnings	Accumulated other comprehensive income	Total
	(Dollars in thousands, except per share data)				
BALANCE AT DECEMBER 31, 2000	$ 2,928	$ 5,055	$ 1,869	$ 81	$ 9,933
Comprehensive income:					
Net income	-	-	592	-	592
Change in net unrealized gain, net of reclassification adjustments and related income taxes	-	-	-	199	199
Total comprehensive income	-	-	-	-	791
Issuance of 1,141 shares of common stock	5	16	-	-	21
Cash dividends declared, $.50 per share	-	-	(293)	-	(293)
BALANCE AT DECEMBER 31, 2001	2,933	5,071	2,168	280	10,452
Comprehensive loss:					
Net loss	-	-	(1,090)	-	(1,090)
Change in net unrealized gain, net of reclassification adjustments and related income taxes	-	-	-	6	6
Total comprehensive loss	-	-	-	-	(1,084)
Cash dividends declared, $.25 per share	-	-	(146)	-	(146)
BALANCE AT DECEMBER 31, 2002	2,933	5,071	932	286	9,222
Comprehensive income:					
Net income	-	-	301	-	301
Change in net unrealized gain, net of reclassification adjustments and related income taxes	-	-	-	(179)	(179)
Total comprehensive income	-	-	-	-	122
Cash dividends declared, $.25 per share	-	-	(146)	-	(146)
BALANCE AT DECEMBER 31, 2003	$ 2,933	$ 5,071	$ 1,087	$ 107	$ 9,198

These consolidated financial statements should be read only in connection with the accompanying summary of significant accounting policies and notes to consolidated financial statements.

EXCHANGE BANCSHARES, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS
Years Ended December 31, 2003, 2002 and 2001

	2003	2002	2001
	(Dollars in thousands, except per share data)		
CASH FLOWS FROM OPERATING ACTIVITIES			
Net income (loss)	$ 301	$ (1,090)	$ 592
Adjustments to reconcile net income (loss) to net cash provided by operating activities:			
Provision for loan losses	250	2,019	15
Depreciation and amortization	257	233	283
Deferred federal income taxes	(59)	(195)	27
Investment securities amortization (accretion), net	312	119	55
Federal Home Loan Bank stock dividends	(19)	(22)	(38)
Securities gains	(29)	(19)	-
Loss (gain) from sale of other real estate owned	34	(8)	-
Effects of changes in operating assets and liabilities:			
Accrued interest receivable and other assets	509	(434)	(46)
Accrued interest payable and other liabilities	(106)	(85)	153
Net cash provided by operating activities	1,450	518	1,041
CASH FLOWS FROM INVESTING ACTIVITIES			
Purchases of available-for-sale securities	(22,069)	(7,314)	(5,196)
Proceeds from sale of available-for-sale securities	2,131	521	-
Proceeds from maturities of available-for-sale securities	13,974	3,887	6,000
Proceeds from maturity of held-to-maturity security	-	-	100
Net decrease (increase) in loans	3,088	6,075	(1,830)
Purchases of premises and equipment	(371)	(201)	(255)
Proceeds from disposal of equipment	14	-	-
Proceeds from sale of other real estate owned	1,476	100	-
Net cash provided by (used in) investing activities	(1,757)	3,068	(1,181)
CASH FLOWS FROM FINANCING ACTIVITIES			
Net increase (decrease) in deposits	(8,596)	5,613	5,124
Repayment of Federal Home Loan Bank borrowings	(14)	(15)	(2,517)
Issuance of common stock	-	-	21
Dividends paid	(146)	(146)	(293)
Other	-	(38)	-
Net cash provided by (used in) financing activities	(8,756)	5,414	2,335
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	(9,063)	9,000	2,195
CASH AND CASH EQUIVALENTS			
Beginning of year	15,765	6,765	4,570
End of year	$ 6,702	$ 15,765	$ 6,765

These consolidated financial statements should be read only in connection with the accompanying summary of significant accounting policies and notes to consolidated financial statements.

EXCHANGE BANCSHARES, INC.
SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Exchange Bancshares, Inc. (the "Company") was incorporated in 1992 in the State of Ohio as a one-bank holding company for its wholly-owned subsidiary, The Exchange Bank (the "Bank"). The Company, through its subsidiary, operates in one industry segment, the commercial banking industry.

The Bank, an Ohio chartered bank organized in 1906, provides financial services through its five branches located in Luckey, Ohio, and nearby communities. These communities are the source of substantially all deposit and loan activities. The majority of the Bank's income is derived from commercial and retail lending activities and investments in securities. Its primary deposit products are checking, savings, and term certificate accounts, and its primary lending products are residential mortgage, commercial, and installment loans. Substantially all loans are secured by specific items of collateral including business assets, consumer assets and real estate. Commercial loans are expected to be repaid from cash flow from operations of business. Real estate loans are secured by both residential and commercial real estate.

Significant accounting policies followed by the Company are presented below:

USE OF ESTIMATES IN PREPARING FINANCIAL STATEMENTS

In preparing consolidated financial statements in conformity with generally accepted accounting principles management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities as of the date of the balance sheet and reported amounts of revenues and expenses during each reporting period. Actual results could differ from those estimates. The most significant areas involving the use of management's estimates and assumptions are the valuation of the allowance for loan losses and provision for loan losses, as well as the valuation allowance for deferred tax assets.

PRINCIPLES OF CONSOLIDATION

The consolidated financial statements include the accounts of the Company and its wholly-owned subsidiary. All significant intercompany balances and transactions have been eliminated in consolidation.

CASH AND CASH EQUIVALENTS

For purposes of the consolidated statements of cash flows, cash and cash equivalents include cash on hand, amounts due from banks, and federal funds sold which mature overnight or within four days.

CASH RESERVE REQUIREMENTS

The Bank is required to maintain reserve funds in cash or on deposit with the Federal Reserve Bank and other correspondent banks The required reserve balance at December 31, 2003 and 2002 was $558,000 and $533,000, respectively.

SECURITIES

Securities are designated at the time of purchase as either held-to-maturity or available-for-sale. Presently, all securities are designated as available-for-sale and carried at fair value, with unrealized gains and losses, net of applicable income taxes, on such securities recognized as other comprehensive income (loss).

Purchase premiums and discounts are recognized as interest income using the interest method over the term of the security.

Investment in Federal Home Loan Bank and Federal Reserve Bank stock is classified as a restricted security, carried at cost, and evaluated for impairment.

Gains and losses on sales of securities are accounted for on a completed transaction basis, using the specific identification method, and are included in non-interest income. Securities are written down to fair value when a decline in fair value is not temporary.

LOANS

Loans that management has the intent and ability to hold for the foreseeable future or until maturity or pay-off generally are stated at their outstanding principal amount, adjusted for charge-offs, the allowance for loan losses and any deferred loan fees or costs on originated loans. Interest is accrued based upon the daily outstanding principal balance. Loan origination fees and certain direct origination costs are capitalized and recognized as an adjustment of the yield of the related loan.

Interest income is not reported when full repayment is in doubt, typically when the loan is impaired or payments are past due over 90 days. All interest accrued but not collected for loans that are placed on nonaccrual or charged-off is reversed against interest income. The interest on these loans is accounted for on the cash-basis or cost-recovery method, until qualifying for return to accrual. Loans are returned to accrual status when all the principal and interest amounts contractually due are brought current and future payments are reasonably assured.

ALLOWANCE FOR LOAN LOSSES

The allowance for loan losses is established as losses are estimated to have occurred through a provision for loan losses charged to income. Loan losses are charged against the allowance when management believes the uncollectibility of a loan balance is confirmed. Subsequent recoveries, if any, are credited to the allowance.

The allowance for loan losses is evaluated on a regular basis by management and is based upon management's periodic review of the collectibility of the loans in light of historical experience, the nature and volume of the loan portfolio, adverse situations that may affect the borrower's ability to repay, estimated value of any underlying collateral and prevailing economic conditions. This evaluation is inherently subjective as it requires estimates that are susceptible to significant revision as more information becomes available.

ALLOWANCE FOR LOAN LOSSES (CONTINUED)

A loan is considered impaired when, based on current information and events, it is probable that the Bank will be unable to collect the scheduled payments of principal or interest when due according to the contractual terms of the loan agreement. Factors considered by management in determining impairment include payment status, collateral value, and the probability of collecting scheduled principal and interest payments when due. Loans that experience insignificant payment delays and payment shortfalls generally are not classified as impaired. Management determines the significance of payment delays and payment shortfalls on a case-by-case basis, taking into consideration all of the circumstances surrounding the loan and the borrower, including the length of the delay, the reasons for the delay, the borrower's prior payment record, and the amount of the shortfall in relation to the principal and interest owed. Impairment is measured on a loan-by-loan basis for commercial, commercial real estate, and construction loans by either the present value of expected future cash flows discounted at the loan's effective interest rate, the loan's obtainable market price, or the fair value of the collateral if the loan is collateral dependent.

Large groups of smaller balance homogeneous loans are collectively evaluated for impairment. Accordingly, the Bank does not separately identify individual consumer and residential loans for impairment disclosures.

OTHER REAL ESTATE OWNED

Other real estate acquired through or in lieu of foreclosure is initially recorded at the lower of cost or fair value, less estimated costs to sell, and any loan balance in excess of fair value is charged to the allowance for loan losses. Subsequent valuations are periodically performed and write-downs are included in other operating expense, as are gains or losses upon sale and expenses related to maintenance of the properties.

PREMISES AND EQUIPMENT

Premises and equipment is stated at cost less accumulated depreciation and amortization. Upon the sale or disposition of the assets, the difference between the depreciated cost and proceeds is charged or credited to income. Depreciation and amortization is determined based on the estimated useful lives of the individual assets (typically 20 to 40 years for buildings and 3 to 10 years for equipment) and is computed using both accelerated and straight-line methods.

ADVERTISING COSTS

All advertising costs are expensed as incurred.

FEDERAL INCOME TAXES

Deferred income taxes are provided on temporary differences between financial statement and income tax reporting. Temporary differences are differences between the amounts of assets and liabilities reported for financial statement purposes and their tax bases. Deferred tax assets are recognized for temporary differences that will be deductible in future years' tax returns and for operating loss and tax credit carryforwards. Deferred tax assets are reduced by a valuation allowance if it is deemed more likely than not that some or all of the deferred tax assets will not be realized. Deferred tax liabilities are recognized for temporary differences that will be taxable in future years' tax returns.

The Bank is not currently subject to state and local income taxes.

TRANSFERS OF FINANCIAL ASSETS

Transfers of financial assets are accounted for as sales, when control over the assets has been surrendered. Control over transferred assets is deemed to be surrendered when (1) the assets have been isolated from the Bank, (2) the transferee obtains the right (free of conditions that constrain it from taking advantage of that right) to pledge or exchange the transferred assets, and (3) the Bank does not maintain effective control over the transferred assets through an agreement to repurchase them before their maturity.

COMPREHENSIVE INCOME

Accounting principles generally require that recognized revenue, expenses, gains and losses be included in net income. Although certain changes in assets and liabilities, such as unrealized gains and losses on available-for-sale securities, are reported as a separate component of the equity section of the balance sheet, such items, along with net income, are components of comprehensive income.

PER SHARE DATA

Net income per share is computed based on the weighted average number of shares of common stock outstanding during each year.

Dividends per share are based on the number of shares outstanding at the declaration date.

RECLASSIFICATIONS

Certain reclassifications of 2002 and 2001 amounts have been made to conform with the 2003 presentation.

NOTE 1 - SECURITIES

The amortized cost and fair value of available-for-sale securities as of December 31, 2003 and 2002, are as follows:

	December 31, 2003			
	Amortized cost	Gross unrealized gains	Gross unrealized losses	Fair value
	(Dollars in thousands)			
U.S. Treasury	$ 1,551	$ 50	$ -	$ 1,601
Federal agency	18,416	135	41	18,510
Mortgage-backed	777	-	6	771
Corporate debt	1,510	24	-	1,534
Total	$ 22,254	$ 209	$ 47	$ 22,416

	December 31, 2002			
	Amortized cost	Gross unrealized gains	Gross unrealized losses	Fair value
	(Dollars in thousands)			
U.S. Treasury	$ 2,584	$ 83	$ -	$ 2,667
Federal agency	10,160	324	-	10,484
Mortgage-backed	2,296	2	-	2,298
Corporate debt	1,533	25	1	1,557
Total	$ 16,573	$ 434	$ 1	$ 17,006

The amortized cost and fair value of available-for-sale securities at December 31, 2003, by contractual maturity, are presented below. Actual maturities may differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call prepayment penalties.

	Amortized cost	Fair value
	(Dollars in thousands)	
Amounts maturing in:		
One year or less	$ 5,010	$ 5,085
After one year through five years	16,467	16,560
After five years through ten years	-	-
Mortgage-backed securities	777	771
Total	$ 22,254	$ 22,416

During 2003, the Bank sold available-for-sale securities for total proceeds of approximately $2,131,000 resulting in $44,000 in gross realized gains (income tax effect of $15,000) and $15,000 gross realized losses (income tax effect of $5,000). During 2002, the Bank sold available-for-sale securities for total proceeds of approximately $521,000 resulting in $19,000 in gross realized gains (income tax effect of $6,000) and no gross realized losses. There were no securities sales in 2001.

NOTE 1 - SECURITIES (CONTINUED)

Securities with a carrying value of approximately $14,112,000 and $11,414,000 were pledged at December 31, 2003 and 2002, respectively, to secure certain deposits.

The following table presents gross unrealized losses and fair value of securities, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position, at December 31, 2003:

	Securities in a continuous unrealized loss position					
	Less than 12 months		12 months or more		Total	
	Unrealized losses	Fair value	Unrealized losses	Fair value	Unrealized losses	Fair value
U.S. Treasury	$ -	$ -	$ -	$ -	$ -	$ -
Federal agency	41	5,114	-	-	41	5,114
Mortgage-backed	6	771	-	-	6	771
Corporate debt	-	-	-	-	-	-
Total temporarily impaired securities	$ 47	$ 5,885	$ -	$ -	$ 47	$ 5,885

There were ten securities in an unrealized loss position at December 31, 2003, none of which were in a continuous unrealized loss position for twelve months or more. Management has considered industry analyst reports, sector credit reports and volatility in the bond market in concluding that the unrealized losses as of December 31, 2003 were primarily the result of customary and expected fluctuations in the bond market. As a result, all security impairments as of December 31, 2003 are considered temporary.

NOTE 2 - LOANS

Loans at December 31, 2003 and 2002, are summarized as follows:

	2003	2002
	(Dollars in thousands)	
Loans secured by real estate:		
Construction	$ 1,291	$ 2,258
Residential properties	32,758	27,687
Nonresidential properties, including farm land	21,377	26,704
Agricultural production	633	1,103
Commercial and industrial	1,838	2,582
Consumer	9,714	11,358
Municipal	944	820
Total	$ 68,555	$ 72,512

NOTE 2 - LOANS (CONTINUED)

The following represents a summary of the activity in the allowance for loan losses for the years ended December 31, 2003, 2002, and 2001:

	2003	2002	2001
	(Dollars in thousands, except per share data)		
Beginning balance	$ 1,417	$ 844	$ 756
Provision for loan losses	250	2,019	15
Loans charged-off	(540)	(1,558)	(260)
Recoveries	268	112	333
Ending balance	$ 1,395	$ 1,417	$ 844

Impaired loans were as follows:

	2003	2002
	(Dollars in thousands)	
Year-end loans with allowance for loan losses allocated	$ 484	$ 429
Amount of the allowance allocated	72	219

	2003	2002	2001
	(Dollars in thousands, except per share data)		
Average of impaired loans during the year	$ 474	$ 428	$ 135
Interest income recognized during impairment	19	2	14
Cash-basis interest income recognized	19	2	14

Loans on non-accrual of interest amounted to $627,000 at December 31, 2003 and $1,351,000 at December 31, 2002. Loans 90 days or more past due and still accruing interest amounted to $1,033,000 at December 31, 2003 and $753,000 at December 31, 2002.

NOTE 3 - PREMISES AND EQUIPMENT

The following is a summary of premises and equipment at December 31, 2003 and 2002:

	2003	2002
	(Dollars in thousands)	
Land	$ 738	$ 738
Buildings	3,333	3,254
Equipment	2,374	2,119
	6,445	6,111
Less accumulated depreciation	(2,950)	(2,716)
Premises and equipment, net	$ 3,495	$ 3,395

Depreciation of premises and equipment amounted to $257,000 in 2003, $233,000 in 2002, and $276,000 in 2001.

NOTE 4 - DEPOSITS

Interest-bearing deposits at December 31, 2003 and 2002, are summarized as follows:

	2003	2002
	(Dollars in thousands)	
Demand	$ 16,628	$ 16,168
Savings accounts	18,543	17,862
Individual retirement accounts	6,442	7,189
Certificates of deposit	40,198	48,091
Total	$ 81,811	$ 89,310

Time deposits at December 31, 2003 and 2002 include individual deposits of $100,000 and over amounting to $11,700,000 and $14,429,000, respectively. Interest expense on time deposits of $100,000 or more amounted to $455,000 for 2003, $530,000 for 2002, and $816,000 for 2001.

The scheduled maturities of time deposits were as follows at December 31, 2003 (dollars in thousands):

2004	$ 28,773
2005	11,300
2006	1,749
2007	2,335
2008	2,483
Total	$ 46,640

Overdrawn demand deposits reclassified as loans amounted to $11,000 and $25,000 at December 31, 2003 and 2002, respectively.

NOTE 5 - BORROWED FUNDS

The Federal Home Loan Bank borrowing at December 31, 2003 and 2002 bears interest at 6.85% fixed rate and is payable in monthly installments through July 2017. The borrowing is secured by FHLB stock amounting to $500,000 and $481,000 at December 31, 2003 and 2002, respectively, and by the Bank's qualified mortgage loan portfolio, amounting to $32,758,000 at December 31, 2003.

Future maturities of the Federal Home Loan Bank borrowing for the five years subsequent to December 31, 2003, are as follows: 2004, $12,000; 2005, $11,000; 2006, $11,000; 2007, $10,000; and 2008, $9,000.

NOTE 6 - OTHER COMPREHENSIVE INCOME

The components of other comprehensive income and related tax effects are as followings for the years ended December 31, 2003, 2002 and 2001:

	2003	2002	2001
	(Dollars in thousands, except per share data)		
Unrealized holding gains (losses) on available-for-sale securities	$ (242)	$ 28	$ 302
Less reclassification adjustment for securities gains recognized in income	(29)	(19)	-
Net unrealized holding gains (losses)	(271)	9	302
Tax effect	(92)	3	103
Other comprehensive income (loss)	$ (179)	$ 6	$ 199

NOTE 7 - FEDERAL INCOME TAXES

The components of the provision (credit) for income taxes for the years ended December 31, 2003, 2002 and 2001 are as follows:

	2003	2002	2001
	(Dollars in thousands, except per share data)		
Current	$ -	$ (390)	$ 242
Deferred	(59)	(195)	27
Total provision (credit) for income taxes	$ (59)	$ (585)	$ 269

The income tax provision (credit) attributable to income from operations differed from the amounts computed by applying the U.S. federal income tax rate of 34% to income (loss) before income taxes as a result of the following:

	2003	2002	2001
	(Dollars in thousands, except per share data)		
Expected tax using federal statutory rate of 34%	$ 82	$ (570)	$ 293
Tax-exempt income, net of interest expense associated with carrying tax-exempt instruments	(8)	(5)	(7)
Decrease in valuation allowance for deferred tax assets	(138)	(19)	(19)
Other, net	5	9	2
Total provision (credit) for income taxes	$ (59)	$ (585)	$ 269

NOTE 7 - FEDERAL INCOME TAXES (CONTINUED)

The significant components of the provision (credit) for deferred income taxes for the years ended December 31, 2003, 2002 and 2001, were as follows:

	2003	2002	2001
	(Dollars in thousands, except per share data)		
Deferred tax provision (credit) arising from the tax benefit of temporary differences, exclusive of item listed below	$ 79	$ (176)	$ 46
Decrease in the valuation allowance for deferred tax assets	(138)	(19)	(19)
Total provision (credit) for deferred income taxes	$ (59)	$ (195)	$ 27

The tax effects of temporary differences which comprise the significant portions of the Company's deferred tax assets and deferred tax liabilities as of December 31, 2003 and 2002, are as follows:

	2003	2002
	(Dollars in thousands)	
Deferred tax assets:		
Allowance for loan losses	$ 338	$ 341
Net operating loss carryforward	257	266
Loans on nonaccrual of interest	31	80
Other, net	21	6
	647	693
Less valuation allowance	128	266
Deferred tax assets, net of valuation allowance	519	427
Deferred tax liabilities:		
Federal Home Loan Bank stock dividends	(52)	(45)
Depreciation of premises and equipment	(81)	(55)
Unrealized gain on securities available-for-sale	(55)	(147)
Total deferred tax liabilities	(188)	(247)
Net deferred tax assets	$ 331	$ 180

At December 31, 2003, the Company has a federal income tax net operating loss carryforward of approximately $756,000 resulting from a 1998 acquisition. Under current tax legislation, the annual limitation on the utilization of the net operating loss carryforward resulting from the acquisition is approximately $57,000. Such limitation resulted from a change in ownership of greater than 50%.

In assessing the realization of deferred tax assets, the Company considers whether it is more likely than not that some portion or all of the deferred tax assets will not be realized. The valuation allowance for deferred tax assets at December 31, 2003 and 2002 is provided for that portion of the net operating loss carryforward for which management believes it is more likely than not will not be realized.

NOTE 8 - FINANCIAL INSTRUMENTS WITH OFF-BALANCE-SHEET RISK

In the normal course of business, the Bank has outstanding commitments and contingent liabilities, such as commitments to extend credit, which are not included in the accompanying consolidated financial statements. The Bank's exposure to credit loss in the event of nonperformance by the other party to the financial instruments for commitments to extend credit and standby letters of credit is represented by the contractual or notional amount of those instruments. The Bank uses the same credit policies in making such commitments as it does for instruments that are included in the consolidated balance sheet.

Financial instruments whose contract amount represents credit risk at December 31, 2003 and 2002, were as follows:

	2003	2002
	(Dollars in thousands)	
Commitments to extend credit	$ 7,113	$ 9,007
Letter of credit	188	138
Total	$ 7,301	$ 9,145

Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. Since many of the commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. The Bank evaluates each customer's creditworthiness on a case-by-case basis. The amount and type of collateral obtained, if deemed necessary by the Bank upon extension of credit, is based on management's credit evaluation. Collateral held varies but may include accounts receivable, inventory, property and equipment, and income-producing commercial properties.

The Bank has not been required to perform on any financial guarantees or incurred any losses on its commitments during the past two years.

Letters of credit are written conditional commitments issued by the Bank to guarantee the performance of a customer to a third party and are reviewed for renewal at expiration. At December 31, 2003, all outstanding letters of credit expire in 2004. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loans to customers. The Bank requires collateral supporting these commitments when deemed necessary.

The Bank maintains several bank accounts at four banks. Accounts at an institution are insured by the Federal Deposit Insurance Corporation ("FDIC") up to $100,000. Cash at one of these institutions exceeded federally insured limits. The amount in excess of the FDIC limit totalled $751,000 at December 31, 2003.

NOTE 9 - RELATED PARTY TRANSACTIONS

In the ordinary course of business, loans are granted to executive officers, directors and their related business interests. The following is an analysis of activity of related-party loans for the years ending December 31, 2003 and 2002:

	2003	2002
Balance at beginning of year	$ 788	$ 624
New loans and advances	1,148	449
Repayments	(556)	(285)
Balance at end of year	$ 1,380	$ 788

Deposits from executive officers, directors and their related business interests at December 31, 2003 and 2002 were approximately $1,848,000 and $815,000, respectively.

NOTE 10 - EMPLOYEE BENEFIT PLAN

The Bank sponsors a discretionary profit sharing plan which also includes 401(k) plan provisions. Under the plan, the Bank matches 50% of employee voluntary deferral contributions up to 3% of the employee's annual salary. The Bank's matching and discretionary profit sharing contributions for 2003, 2002 and 2001 were $20,000, $23,000, and $33,000, respectively.

NOTE 11 - REGULATORY MATTERS

The Company (on a consolidated basis) and Bank are subject to various regulatory capital requirements administered by the federal and state banking agencies. Failure to meet minimum capital requirements can initiate certain mandatory, and possibly additional discretionary actions by regulators that, if undertaken, could have a direct material effect on the Company's and Bank's financial statements. Under the capital adequacy guidelines and the regulatory framework for prompt corrective action, the Company and Bank must meet specific capital guidelines that involve quantitative measures of the assets, liabilities, and certain off-balance sheet items as calculated under regulatory accounting practices. The capital amounts and classification are also subject to qualitative judgments by the regulators about components, risk weightings, and other factors. Prompt corrective action provisions are not applicable to bank holding companies.

Quantitative measures established by regulation to ensure capital adequacy require the Company and Bank to maintain minimum amounts and ratios (set forth in the table below) of total and Tier I capital (as defined in the regulations) to risk-weighted assets (as defined), and of Tier I capital to average assets (as defined). Management believes, as of December 31, 2003 and 2002, that the Company and Bank met all capital adequacy requirements to which they are subject.

As of December 31, 2003, the most recent notification from federal and state banking agencies categorized the Bank as well capitalized under the regulatory framework for prompt corrective action. To be categorized as well capitalized, an institution must maintain minimum total risk-based, Tier I risk-based and Tier I leverage ratios as set forth in the following tables. There are no conditions or events since that notification that management believes have changed the Bank's category.

NOTE 11 - REGULATORY MATTERS (CONTINUED)

The actual capital amounts and ratios of the Company and Bank as of December 31, 2003 are presented in the following table:

	Actual		Minimum capital requirement		Minimum to be well capitalized under prompt corrective action provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
			(Dollars in thousands)			
As of December 31, 2003:						
Total Capital (to Risk-Weighted Assets)						
Consolidated	$ 9,858	14.9%	$ 5,295	≥ 8.0%	$ N/A	N/A
Bank	9,687	14.7	5,275	≥ 8.0%	6,594	≥ 10.0%
Tier I Capital (to Risk-Weighted Assets)						
Consolidated	$ 9,027	13.6%	$ 2,647	≥ 4.0%	$ N/A	N/A
Bank	8,856	13.4	2,638	≥ 4.0%	3,956	≥ 6.0%
Tier I Capital (to Average Assets)						
Consolidated	$ 9,027	8.6%	$ 4,186	≥ 4.0%	$ N/A	N/A
Bank	8,856	8.5	4,177	≥ 4.0%	5,221	≥ 5.0%

The actual capital amounts and ratios of the Bank as of December 31, 2002 are presented in the following table:

	Actual		Minimum capital requirement		Minimum to be well capitalized under prompt corrective action provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
			(Dollars in thousands)			
As of December 31, 2002:						
Total Capital (to Risk-Weighted Assets)						
Bank	$ 9,538	12.3%	$ 6,192	≥ 8.0%	$ 7,740	≥ 10.0%
Tier I Capital (to Risk-Weighted Assets)						
Bank	$ 8,565	11.1%	$ 3,096	≥ 4.0%	$ 4,644	≥ 6.0%
Tier I Capital (to Average Assets)						
Bank	$ 8,565	7.7%	$ 3,358	≥ 3.0%	$ 5,597	≥ 5.0%

Generally, subject to certain minimum capital requirements, the Bank may declare a dividend without regulatory approval unless the total dividends in a calendar year exceed the total of the Bank's net profits for the year combined with its retained profits of the two preceding years.

NOTE 12 - CONDENSED PARENT COMPANY FINANCIAL INFORMATION

Summary of condensed financial information of the parent company as of December 31, 2003 and 2002, and for each of the three years in the period ended December 31, 2003 follows:

CONDENSED BALANCE SHEETS	**2003**	**2002**
	(Dollars in thousands)	
Assets:		
Cash and cash equivalents	$ 51	$ 121
Investment in subsidiary bank	9,027	8,934
Other assets	123	190
Total assets	$ 9,201	$ 9,245
Other liability	$ 3	$ 23
Shareholders' equity:		
Common stock	2,933	2,933
Additional paid-in capital	5,071	5,071
Retained earnings	1,087	932
Accumulated other comprehensive income	107	286
Total shareholders' equity	9,198	9,222
Total liabilities and shareholders' equity	$ 9,201	$ 9,245

CONDENSED STATEMENTS OF OPERATIONS	**2003**	**2002**	**2001**
		(Dollars in thousands)	
Income:			
Dividends from subsidiary bank	$ 150	$ 329	$ 400
Interest on deposits in subsidiary bank	1	5	11
Total income	151	334	411
Expenses – professional fees and other expenses	184	352	108
Income (loss) before income taxes and equity in undistributed net income of subsidiary	(33)	(18)	303
Income tax benefit	62	118	33
Income before undistributed earnings of subsidiary	29	100	336
Equity in undistributed net income of subsidiary	272	(1,190)	256
Net income (loss)	$ 301	$ (1,090)	$ 592

NOTE 12 - CONDENSED PARENT COMPANY FINANCIAL INFORMATION (CONTINUED)

CONDENSED STATEMENTS OF CASH FLOWS	2003	2002	2001
	(Dollars in thousands)		
Cash flows from operating activities:			
Net income (loss)	$ 301	$ (1,090)	$ 592
Adjustments to reconcile net income (loss) to net cash provided by operating activities:			
Equity in undistributed earnings of subsidiary	(272)	1,190	(256)
Change in other assets	67	7	(155)
Change in other liabilities	(20)	(81)	(25)
Net cash provided by operating activities	76	26	156
Cash flows from financing activities:			
Proceeds from sale of common stock	-	-	22
Cash dividends paid	(146)	(146)	(293)
Net cash used in financing activities	(146)	(146)	(271)
Net decrease in cash and cash equivalents	(70)	(120)	(115)
Cash and cash equivalents at:			
Beginning of year	121	241	356
End of year	$ 51	$ 121	$ 241

NOTE 13 - SUPPLEMENTAL CASH FLOW DISCLOSURES

Supplemental cash flows disclosures consist of the following at December 31, 2003, 2002, and 2001:

	2003	2002	2001
	(Dollars in thousands)		
Cash paid during the year for:			
Interest	$ 2,046	$ 2,938	$ 4,111
Income taxes	$ 149	$ 291	$ 146
Non-cash operating activity:			
Change in deferred income taxes on net unrealized gain on available-for-sale securities	$ (92)	$ 3	$ 103
Non-cash investment activities:			
Transfer of loans to other real estate owned	$ 597	$ 1,150	$ -
Change in net unrealized gains on available-for-sale securities	$ (271)	$ 9	$ 302

NOTE 14 – CONTINGENT LIABILITIES

In the normal course of business, the Company and its subsidiary may be involved in various legal actions, but in the opinion of management and its legal counsel, the ultimate disposition of such matters is not expected to have a material adverse effect on the consolidated financial statements.

NOTE 15 - FAIR VALUE OF FINANCIAL INSTRUMENTS

Statement of Financial Accounting Standards No. 107, "Disclosures about Fair Value of Financial Instruments", requires disclosure of fair value information about financial instruments, whether or not recognized in the statement of financial condition. In cases where quoted market prices are not available, fair values are based on estimates using present value or other valuation techniques. Those techniques are significantly affected by the assumptions used, including the discount rate and estimates of future cash flows. In that regard, the derived fair value estimates cannot be substantiated by comparison to independent markets and, in many cases, could not be realized in immediate settlement of the instruments. Statement 107 excluded certain financial instruments and all nonfinancial instruments from its disclosure requirements. Accordingly, the fair value amounts presented do not represent the underlying value of the Company. The following methods and assumptions were used by the Company in estimating its fair value disclosures for financial instruments:

Cash and cash equivalents:

The carrying amounts reported for cash and cash equivalents approximate their fair values.

Securities:

Fair values for securities are based on quoted market prices.

Loans:

For variable-rate loans that reprice frequently and with no significant change in credit risk, fair values are based on carrying amounts. The fair values for other loans (i.e., fixed rate commercial real estate and rental property mortgage loans and commercial and industrial loans) are estimated using discounted cash flow analysis, based on interest rates currently being offered for loans with similar terms to borrowers of similar credit quality. Loan fair value estimates include judgments regarding future expected loss experience and risk characteristics. Fair values for impaired loans are estimated using discounted cash flow analysis or underlying collateral values.

Deposits:

The fair values disclosed for demand deposits are, by definition, equal to the amount payable on demand at the reporting date (that is, their carrying amounts). The carrying amounts of variable-rate, fixed-term money-market accounts and certificates of deposit approximate their fair values. Fair values for fixed-rate certificates of deposit are estimates using a discounted cash flow calculation that applies interest rates currently offered on certificates to a schedule of aggregated contractual expected monthly maturities on time deposits.

Accrued interest:

The carrying amounts of accrued interest approximate the fair values.

NOTE 15 - FAIR VALUES OF FINANCIAL INSTRUMENTS (CONTINUED)

Borrowed funds:

The carrying amounts of borrowed funds are estimated using discounted cash flow analysis based on interest rates currently offered on borrowed funds.

The estimated fair values at December 31, 2003 and 2002 are as follows:

	2003		2002	
	Carrying amount	Estimated fair value	Carrying amount	Estimated fair value
	(Dollars in thousands)			
FINANCIAL ASSETS				
Cash and cash equivalents	$ 6,702	$ 6,702	$ 15,765	$ 15,765
Securities	23,081	23,081	17,652	17,652
Loans, net	67,160	68,627	71,095	70,152
Accrued interest receivable	697	697	671	671
Total	$ 97,640	$ 99,107	$ 105,183	$ 104,240
FINANCIAL LIABILITIES				
Deposits	$ 92,249	$ 92,564	$ 100,845	$ 101,833
Borrowed funds	86	86	100	100
Accrued interest payable	109	109	190	190
Total	$ 92,444	$ 92,759	$ 101,135	$ 102,123

NOTE 16 - QUARTERLY CONDENSED FINANCIAL DATA (UNAUDITED)

The following is a summary of selected unaudited quarterly financial data for 2003 and 2002:

	Interest income	Net interest income	Provision for loan losses	Net income (loss)	Net income (loss) per common share (basic and diluted)
2003					
First quarter	$ 1,550	$ 995	$ -	$ 126	.21
Second quarter	1,468	956	-	98	.17
Third quarter	1,498	1,025	20	78	.13
Fourth quarter	1,364	939	230	(1)	-
2002					
First quarter	$ 1,854	$ 1,111	$ 46	$ 143	.24
Second quarter	1,853	1,165	169	38	.06
Third quarter	1,786	1,061	825	(469)	(.80)
Fourth quarter	1,542	826	979	(802)	(1.36)

This information is an integral part of the accompanying consolidated financial statements.

CORPORATE INFORMATION

DIRECTORS OF EXCHANGE BANCSHARES, INC.

Cecil R. Adkins, Manufactured Housing, Developer
Walbridge, Ohio
Norma J. Christen, Restaurant Owner
Bowling Green, Ohio
Mark S. Derkin, Specialized Industrial Components Distributor, Maumee, Ohio
Donald P. Gerke, Educator
Pemberville, Ohio
Joseph R. Hirzel, Food Processing
Pemberville, Ohio
Rolland I. Huss, Farmer
Luckey, Ohio
Marion Layman, Banker
Luckey, Ohio
David G. Marsh, Mortuary Owner
Luckey, Ohio
Edmund J. Miller, Television Broadcasting, Engineer
Luckey, Ohio
Victor J. Proffitt, Banker
Holland, Ohio

EXECUTIVE OFFICERS OF EXCHANGE BANCSHARES, INC.

Marion Layman, Chairman
Victor J. Proffitt, President & CEO
Joseph R. Hirzel, Secretary
Thomas E. Funk, Vice President, Treasurer & CFO

ANNUAL MEETING

Wednesday, May 19, 2004, following the 6:30 p.m. dinner for shareholders
4900 Sugar Ridge Road
Pemberville, Ohio 43450

INDEPENDENT AUDITORS

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TRANSFER AGENT

Illinois Stock Transfer Company
209 West Jackson Blvd., Suite 903
Chicago, Illinois 60606
(312) 427-2953 or (800) 757-5755
Fax (312) 427-2879

COMMON STOCK

There were 586,644 common shares of Exchange Bancshares, I outstanding on March 22, 2004, held of record by approxima 796 shareholders. Since January 1, 1994, Exchange Bancsha Inc.'s common shares have been traded on the over-the-cou market. Two brokerage firms serve as limited market mak Sweney Cartwright & Co. and McDonald & Company. following represents high and low trading prices and divide declared during each respective quarter during 2003 and 2(Trading prices reflect inter-dealer prices, without retail mark- mark-down or commission.

2003	High	Low	Dividenc declared
First Quarter	$19.75	$18.10	$ -
Second Quarter	$18.75	$17.25	$0.20
Third Quarter	$18.25	$17.35	$ -
Fourth Quarter	$19.75	$17.55	$0.05

2002	High	Low	Dividenc declared
First Quarter	$19.00	$18.00	$ -
Second Quarter	$19.60	$18.15	$0.20
Third Quarter	$20.00	$19.00	$ -
Fourth Quarter	$20.00	$19.00	$0.05

A copy of Exchange Bancshares, Inc.'s Annual Report on Form KSB, as filed with the Securities and Exchange Commission available at no charge to shareholders upon request to:

Joseph R. Hirzel, Secretary
Exchange Bancshare, Inc.
237 Main Street, P. O. Box 177
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This information is an integral part of the accompanying consolidated financial statements.

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